436 Lithuania. The situation in Lithuania immediately after the war
722 was rather different.[1] The currency in circulation at the outbreak of War was the rouble, but with the German occupation Reichsmarks came into circulation. To regularize this position a special institution was set up in 1916 by the German authorities, which issued the so-called 'Oberost' notes in exchange for roubles and marks. But, owing to the conservative instinct of the peasants, roubles tended to be hoarded, and thus the backing for the 'Oberost' money came to be preponderantly German currency. This system was maintained after the declaration of independence, and Lithuania had actually had no currency of her own until 1922, for the authorities continued to issue 'Oberost' notes, which were known as 'Auksinas'. This currency naturally fluctuated with the German mark, and the rapid depreciation of the latter during 1922 made the introduction of an independent Lithuanian currency an urgent necessity. It was finally
652 decided to create the litas, the parity of which was fixed at one-tenth
436 of the U.S. gold dollar,[2] since this currency was familiar to many Lithuanians, owing to the large number of their compatriots who
439 had emigrated to the United States. The currency came into circula-
652 tion on October 1, 1922. Simultaneously a bank of issue, the
453 *Lietuvos Bankas*, was established with a gold reserve consisting largely of 3 million gold roubles received from Russia under the Peace Treaty. The bank was granted the sole right of note circulation, one-third of which must be covered by gold. Half of the share capital is held by the State, and provision is made by statute for the exercise of the authority of the State over certain of the bank's activities.

436 *Estonia*. The monetary history of Estonia during the period was
652 rather different from that of the other two countries. This was due to Estonia's credit policy. Shortly after the declaration of independence Estonia began to issue its own currency, the Estonian mark, based roughly on the German mark, of which a great number were then in circulation. The extraordinary needs of the war with Russia led to a steady depreciation, which lasted until about the middle of 1921. But, though the need for extraordinary expenditure such as that required in the previous two years had ceased by 1921, the policy of the Central Bank (*Eesti Pank*), which had been formed in 1919, somewhat aggravated the situation. This bank was a State institution and acted as a bank of issue. But it was also the most important commercial bank of the country, for, during the years 1921–3, the Government endeavoured to restore something of Estonia's former industrial activity by supplying industry with

[1] A full account will be found in Dr. Kazys Sruoga, *Die Wirtschaft der Republik Litauen und ihre Notenemission*, Kaunas, 1930.

[2] Parity to the gold £ being, therefore, 48·666.

436 working capital through the *Eesti Pank*. Meanwhile, though the
652 bank was able to keep the mark more or less stable at the rate to
648 which it had depreciated by 1921, this was effected only at the cost of a large proportion of its reserves. This led to a severe crisis in the autumn of 1924 and the League of Nations was called in to advise.[1]

The restriction of credit which followed on this step enabled Estonia to maintain the stability of the currency at the depreciated rate. For the *de jure* stage of stabilization, appeal was again made to the League in November 1926. Their report[2] recommended the reform of the *Eesti Pank*, and the transfer of the long-term assets it had accumulated through the Government's earlier industrial policy to a specially created Mortgage Institute, both of which recommendations had been made in the earlier report but had not yet been put
648 into effect. The League also advised the introduction of a new
457 currency. To enable these reforms to be realized an international loan was required, and, if the necessary changes were made, the League declared its readiness to allow the loan to be issued under its auspices.

457 The loan was issued in June 1927, £700,000 in London and
652 Amsterdam at 94½, and $4,000,000 in New York at the same price. £1,000,000 of the proceeds went to purchase the long-term assets of the *Eesti Pank*, which were then transferred, as recommended, to
[648] the newly created Mortgage Institute. Efforts were made by the
[453] League to secure some measure of independence for the Central Bank from the State, and the State undertook to sell certain of its shares in the bank.[3] The scope of the bank's lending operations were strictly limited by the new Statutes. It was also granted the monopoly of the note issue, and the legal cover, which had previously been such as to encourage its commercial operations, was to consist as to not less
436 than 40 per cent. of gold or 'gold exchange'. Finally, the parity of
453 the new currency, the Estonian kroon, was fixed at that of the Swedish crown,[4] and the currency was put into circulation at the beginning of 1928.

Once *de jure* stabilization was achieved, the stability of these currencies was maintained throughout the period without recourse to official exchange restrictions. There was also a steady increase in the gold and foreign exchange holdings of the Central Banks, though, except in Lithuania, there was a tendency for reserves to fall towards

[1] The report of the Financial Committee of the League was issued in March, 1925: see League Document C. 240, M. 92, 1925, II.

[2] *Banking and Currency Reform in Estonia, May 25, 1927*: League Document C. 227, M. 89, 1927, II.

[3] According to Kisch and Elkin, op. cit., p. 27, a large proportion of its holding was sold in 1929.

[4] Giving a parity to the gold £ of 18·1595.

436 the end of the period. At all times, however, the cover for the note
453 circulation was well above the legal requirements. The position can be seen from the following table:

TABLE 27. *Gold and Foreign Currency Reserves: Notes in Circulation*

End of	Estonia* (kr.) Central Bank		Latvia (lats) Central Bank		Lithuania (lits) Central Bank	
	Gold and foreign currency reserves	Notes in circulation	Gold and foreign currency reserves‡	Notes in circulation†	Gold and foreign currency reserves	Notes in circulation
1922	..	37	45	54	33	30
1923	14	34	67	63	66	60
1924	13	36	71	68	94	93
1925	13	35	53	61	64	82
1926	14	34	55	62	69	87
1927	22	39	76	71	86	97
1928	31	36	101	77	80	85
1929	27	34	80	83	113	95
1930	23	32	65	86	125	117

* The figures for 1922–6 are obtained by revaluing the original figures, which are given in Estonian marks, at the official rate of conversion into kroon (100 Estonian marks = 1 kroon).

† Including the Treasury note issue. ‡ Including those held by the State.

2. FOREIGN DEBT

457 The Baltic States all suffer from lack of capital, and it was therefore inevitable that during this period there should be some borrowing abroad. This borrowing, however, was not excessive, and the meeting of the foreign debt service has never been as difficult a problem as, for example, it has been in Central and South-East Europe. But no account of the economic and financial structure of these States would be complete without some description of the foreign debt.

The position at the end of 1930, by which point foreign indebtedness had probably reached its greatest dimensions,[1] can be seen from the following table, based on figures taken from the League of Nations Memorandum on *Balances of Payments* for 1933. The capital raised during the period is represented largely by items 2 and 4. No data are available for estimating Estonia's private short-term debt, but from figures given in this publication for subsequent years it appears to have been small, if not negligible. It will be seen that, while the per head foreign indebtedness in Estonia

[1] Lithuania, however, obtained a loan from the Swedish Match Co. in 1930, payments to Lithuania in respect of which continued to be made until 1932.

652 State had begun to encroach upon the field of private enterprise. The implications of this movement will become clear when the period after 1931 is considered.

4. The Banking System

●453 Before the War banking had been fairly highly developed in Estonia and Latvia. The centre of the system, however, was naturally St. Petersburg. There was a considerable number of commercial banks in most of the more important towns of the Baltic Provinces, mostly with head offices in that city.. Indeed, it was a frequent complaint that the commercial banks invested an excessive part of the deposits which they drew from the Baltic Provinces in [439] other parts of the Empire. These banks were largely concerned with the foreign trade conducted through Riga, Reval, and the other large ports and, to a lesser extent, with the financing of industry. In addition, since the beginning of the century, the Russian authorities had done something to foster the growth in all three countries of mortgage institutes for local requirements, and of municipal banks. The mutual credit association, also, was beginning to become popular.

The War, of course, destroyed this system. Liquid assets held in the branches were withdrawn to the head office, records were destroyed, and finally, in many cases, the parent institution ceased to exist. But the system left its mark on the Baltic States. For, when these States began to develop banking systems of their own, an unusually clear distinction was drawn between the function of the commercial banks and that of the other units of the system. Banking during this period grew up largely on the principle of the specialization of functions; and, even in Lithuania, where financial technique is less developed than in the other countries, there is a comparatively large number of categories of banks. Thus, in addition to joint stock commercial banks proper, there are usually to be found private banks, rural and urban credit institutions, mutual credit associations, and municipal banks, apart from the banking apparatus of the co-operative system.

In spite of this diversity of types, there is nothing in the Baltic States which corresponds to a money market, and the credit system is directly dependent on the central bank. This usually tended to render credit expensive, and during most of this period the rate of interest was considerably higher than in Western Europe. It would [151] certainly have been higher still but for the fact that the investments of foreign banks in the commercial banking systems of the Baltic States were substantial, and foreign credits were therefore easy to obtain at comparatively cheap rates. This, together with the return of more normal conditions after the War, led to a noteworthy expansion of

commercial banking, particularly in Estonia and Latvia, which continued to the end of this period. The expansion was not accompanied by any extension of the principle of branch banking, which rarely occurs, but, perhaps for this reason, a large number of smaller banks came into being.

Commercial Banks. In Estonia and Latvia these banks were often created out of the business of banks which had existed before the War, though in a few cases there were joint stock commercial banks, and occasionally private banks, which survived the War. In Lithuania nearly all the more important commercial banks were created after the War. In all three countries the joint stock form is usual. The commercial banks are to a very large extent concerned with financing foreign trade, and, probably for this reason, the commercial banking system of Estonia and Latvia is more highly developed than that of Lithuania. They do to some extent finance local industries, though not to the same degree as in Central Europe, and their long-term loans to industrial undertakings are comparatively small. The interest of foreign capital in this type of bank is considerable. The United Kingdom and Germany have the greatest participation in the commercial banks of Estonia and Latvia; Germany, however, is the only foreign country with any substantial investments in Lithuanian banking. The fact that the banks which finance foreign trade are themselves often financed largely by foreign capital was of great importance to those States during the period, for there is little doubt that foreign trade would not have developed so fast if foreign credits had not been available in this manner. In the event, commercial banking expanded very rapidly. Indeed, the scarcity of capital during this period often compelled these banks to work on a basis which might well be called overtrading. The following table,[1] shows the position at the peak of this period of expansion:

TABLE 31. *Position of Commercial Banks*

	Estonia as at 1.12.30	*Latvia as at 31.12.29*	*Lithuania* as at 31.12.29*
Number of Banks	40	20	9
	(mill. kr.)	(mill. lats)	(mill. lits)
Total assets	194·0	199·7	60·4
Cash	4·0	7·2	3·4
Loans and advances	86·6	86·2	23·7
Paid-up capital and reserves	15·6	33·7	13·4
Deposits	96·0	61·6	33·6

* Excluding Memel.

[1] Based on figures given in the League of Nations, *Memorandum on Commercial Banks, 1929–1934*, Geneva, 1935.

1: Anonymous U-4 (no date)1938 RB1 Baltic States RB1

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TABLE 55. *Gross Foreign Indebtedness*

(In million Swiss francs)

At end of:	Estonia			Latvia		Lithuania	
	1930	1935	1936	1930	1935	1930	1934
1. Intergovernmental debt	114·0	67·5	67·6	85·1	52·7	36·2	22·6
2. Other Government and municipal debt . . .	51·7	23·3	26·9	31·1	29·5	37·7	28·0
3. Foreign long-term investments in banks, industry, &c.	45·8	23·3	22·1	104·8	82·9	33·6	43·6
4. Private short-term debt and other debt	?	0·9	3·8	137·3	108·7	15·9	10·6
Total	(211·5)	115·0	120·6	358·3	273·6	123·4	104·8

The large reduction in intergovernmental debt is due to the depreciation of the dollar and sterling, which accounts also for much of the decrease in the other items, especially Government and municipal debt. The small decrease in Latvia's Government and municipal debt is due to the inclusion, in 1935, of the Riga debt already mentioned. It remains to be added that neither Estonia nor Latvia has had the full benefit of this decrease in their foreign indebtedness, owing to the depreciation of their respective currencies. Yet the amount of foreign debt is still relatively small, and so far as can be seen the service imposes no heavy burden on any of the three States.

4. THE BANKING SYSTEM, 1931–7

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The crisis of 1931 had a severe effect upon the entire banking system. The commercial banks, which depended largely upon the financing of foreign trade, were the most seriously affected, owing to the general decrease of exports and imports, and especially to the exchange restrictions, which generally had the effect of centralizing dealings in foreign currency in the Central Banks or their nominees, while, as was seen, a large number of foreign credits made available to commercial banks in these countries by their foreign correspondents was withdrawn during 1930 and 1931. Mortgage banks, also, suffered severely through the decline in agricultural prices, which made it difficult, if not impossible, for peasants to meet the service of loans contracted when prices were considerably higher; and, as already noted, measures had to be taken to relieve such debtors in Estonia and Latvia. Finally, the general reduction in economic activity was inevitably reflected in the co-operative system, though the effect of the depression was less evident in this case than elsewhere.

The general recovery of the economic situation in all three countries has naturally been followed by an improvement in the position of

453 458 652 the banking system, particularly in that of the commercial banks. In the latter case the recovery has been accompanied, in Latvia and Estonia, by developments which are of some interest, and which are noted below. For reasons of space it is impossible to describe the developments which have taken place during the last few years in the other branches of the banking system. This omission is not of great importance, since the co-operative system, for example, remains, in principle at any rate, what it was before the depression. However, the difficulties encountered by the commercial banks since 1930 have somewhat increased the part which it plays in financing the internal distribution and export of agricultural goods, and even in the import of agricultural machinery and artificial manure. A further development outside the realm of commercial banking is the increase, since 1931, of deposits with Government savings banks, perhaps as a consequence of the lack of confidence, at any rate until the last year or two, in the commercial banks. Finally, it should be said that no complete statistics are available in a comparable form to show developments in the banking system of the Baltic States as a whole. A table showing the movement of deposits since 1929 is given on page 187.

Latvia. The most remarkable developments in commercial banking have taken place in Latvia. In order to explain these developments it is necessary to begin with the crisis of 1931. The German banking crash in July of that year led to an almost complete collapse of Latvia's commercial banking system. German withdrawals of credit and deposits had been particularly severe, and in the first fortnight of that month two of the largest commercial banks, which had close relations with the German banking system, stopped payment. The prevailing uncertainty led to conditions bordering on panic in Latvia, and there was a large number of domestic withdrawals. It finally became necessary for the Government, on July 21, to authorize the banks to restrict withdrawals of deposits to 5 per cent. of the total deposits per week, a figure which was subsequently reduced to 2½ per cent. This regulation was kept in force until the latter part of 1932, and only one of the private banks did not take advantage of it, but continued to pay out deposits in full during the whole period. In this bank a considerable amount of British capital was invested.

But, though this measure checked the further progress of the credit crisis, it naturally did not promote the return of confidence in the commercial banking system. For two years, as can be seen from the table at the end of this section, deposits with the joint stock and municipal and mutual credit banks remained at approximately the level to which they had fallen by the end of 1931, i.e. about half

1: Anonymous U-4 (no date)1938 RB1 Baltic States RB1
Latvia
Estonia

that of the peak year, 1929. Meanwhile, the banks were not able to improve their position through any increase in economic activity, for such an increase was prevented by the monetary policy pursued by the Government, at any rate until 1935.[1]

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At this stage the State, now converted to totalitarian principles, intervened with a programme of reform. The instrument of this reform was the *Latvijas Kreditbanka*, founded by the Government in April 1935 with the comparatively large capital of 15 million lats.[2] The bank is directly controlled by the Ministry of Finance, and is empowered by decree to take over other banks or industrial concerns, at an arbitrary valuation from which there is no appeal, if the Minister of Finance is satisfied that they are in difficulties. This institution proceeded to put into effect a programme of compulsory amalgamation by taking over or liquidating a large number of commercial banks, in some of which a considerable amount of foreign capital was invested and, at the same time, to carry on ordinary banking business in competition with the few banks which remained. Thus, the bank began to acquire for itself a position in the financial system very similar to that of a monopoly.[3]

During 1936 and 1937 the importance of the *Latvijas Kreditbanka* has been still further extended. The bank has begun to take a direct shareholding interest in a number of important industrial concerns of a very varied nature, and thus to acquire a 'sphere of interest' in industry on behalf of the Government. While the Government has stopped short of the nationalization of all private interests, the powers possessed by the *Kreditbanka* are so large, and are exercised so arbitrarily, that considerable anxiety exists, not only in Latvia itself, but also abroad. Reassuring speeches, however, were made by the authorities during the first few months of 1937, which have done something to allay these feelings.[4]

Estonia. The effect of the crisis of 1931 on the commercial banks in Estonia was less severe than in Latvia, for, though the volume of credits withdrawn by foreign correspondents in 1931 was large, the connexion with the German banking system was perhaps less close. At all events, there was no collapse of the banking system similar to that which took place in Latvia, and drastic reconstructions were

[1] See above, pp. 173–4.

[2] This was increased to 20 million lats in 1936.

[3] A similar policy was adopted with regard to insurance in Latvia. A law was passed in October 1934 granting the State Insurance Department of the Ministry of Finance wide powers over private insurance companies, requiring them to pay 10 per cent. of their premiums to the Department, and requiring fire policies to be reinsured with the Department to the extent of 25 per cent. Foreign insurance companies and their agents were forbidden to operate in Latvia. See D.O.T.: *Economic Conditions in Latvia, January 1935*, publ. 1935, pp. 7–8.

[4] The effect of recent developments in Latvian banking is discussed in the *Economist* of March 14, 1936, and January 9, 1937.

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postponed until 1934, when one of the largest commercial banks was finally compelled to write down its capital by a substantial proportion. Similarly, the direct part played by the State in dealing with the banking system was very much smaller, though mention should be made of the introduction of a national credit law in March 1932, which supplemented the old Russian credit statutes hitherto in force.

The abandonment of the gold standard was followed by a considerable improvement in the banking position as a whole, and by 1935 most of the more important units of the system had completely recovered from the effects of the depression. The further growth of activity since 1935, and in particular the increase of industrialization, led to a considerable expansion of credit. Its extent may be judged from the fact that on December 1, 1937[1], the loans and discounts of 13 joint stock banks and the 25 principal co-operative banks stood at 97·2 mill. kr., as compared with 73·3 mill. kr. at the end of 1932. There was a similar movement also in the loans made by the Central Bank. This expansion created a serious problem for the Estonian credit system. For, since the middle of 1936, there had been a number of indications suggesting that economic activity had reached something like a boom level. In industry, as has been seen, there had actually been a shortage of labour, which had begun to attract workers from agriculture. The note circulation, also, had expanded —from 32·1 million kroon at the end of 1932 to 49·1 millions at the end of 1937—though there had also been an increase in the gold cover. But, as was shown, prices also had risen very rapidly. In these circumstances the continuous expansion of credit by the banking system aroused some apprehension, especially as there was a large import surplus both in 1936 and 1937. However, although by March 1938 no measures had been taken to restrict credit, there were signs that the authorities realized the dangers of the situation and were attempting to control the volume of capital outlay in building and industry.[2]

Lithuania. Developments in the commercial banking system in Lithuania were of less importance than in the other two countries. As already noted, the crisis of 1931 did not lead to a flight from the currency or to foreign withdrawals of capital on any great scale. There was, it is true, a number of domestic withdrawals in 1931, from which the commercial banks were just beginning to recover when the events of 1935 referred to above[3] took place. Even so, the

[1] Subsequent figures are not comparable.

[2] It is of interest, however, in this connexion that in the spring of 1938 a proposal was being discussed in the Estonian press, according to the *Revalsche Zeitung* of March 5, 1938, for increasing the capital of the *Eesti Pank*. Since then little more has been heard of the proposal.

[3] See p. 175.